

THE STATE OF NEW HAMPSHIRE
Before the
PUBLIC UTILITIES COMMISSION

Investigation of Verizon New Hampshire's)
Treatment of Yellow Pages Revenues)

DT 02-165

PRE-HEARING BRIEF BY OFFICE OF CONSUMER ADVOCATE

The Office of Consumer Advocate ("OCA") files this Pre-hearing Brief in order to address a number of legal issues underlying the Commission's authority to require that a portion of the Verizon affiliate's yellow pages revenue be imputed to its regulated telephone company, Verizon New Hampshire ("Verizon-NH"). Since this brief is submitted prior to hearing and without the support of a fully developed factual record, the OCA reserves the right to submit a Post-hearing Brief that includes these issues with the benefit of any additional facts presented at hearing, as well as any additional legal issues which may arise from facts developed at hearing.

Introduction

The OCA will not address the legal issue of whether fines against Verizon-NH are appropriate. From a residential ratepayer point of view OCA believes that adjusting Verizon-

NH's revenues by imputation is the most critical issue presented in this docket. Accordingly OCA recommends that the Commission pursue penalty issues in a separate docket so as not to divert time and attention away from the imputation issues. In OCA's view Verizon-NH's failure to file a copy of a contract with the Commission when it changed the terms of its yellow page affiliate contract on January 1, 1999, was a violation of RSA 366:3. Given the significant revenue impact of this new affiliate arrangement, however, OCA prefers to expend its resources supporting the Commission's authority to impute yellow pages revenues in order to obtain near term revenue relief, rather than to fight over the meaning and intent of RSA 366:3. Fining Verizon-NH for this filing omission may provide some incentive for the utility to conduct itself differently in the future, however, OCA believes that other regulatory responses, discussed below, may be more effective.

When a utility has made changes in its affiliate contracts that cause a profound impact upon regulated revenues, without meeting its burden of insuring that the Commission fully understands the revenue impact of those changes, the appropriate regulatory response is to assume that this type of behavior will continue. Given this fact, the Commission must increase its supervision of this utility. Increased vigilance will require that additional resources be committed to regulatory oversight. To that end, annual outside audits of Verizon-NH are needed as well as more detailed reporting requirements, including for example, New Hampshire specific balance sheets and cash flow statements. These measures are needed in order to understand what other management decisions Verizon-NH is making which may be impacting regulated costs and revenues.

In addition, in order to analyze the impact on Verizon-NH's regulated revenues the Commission will need to compel Verizon-NH to disclose revenues and expenses moving in and

out of its other affiliates, both regulated and unregulated. To date Verizon-NH continues to refuse to divulge this information. Given Verizon's current attitude toward producing meaningful information about its inter-company transfers, it has basically grown beyond the reach of state regulation. If the Commission lacks the authority to compel production of this data, it may refer these inter-company transfers to the Securities and Exchange Commission for audit and investigation. Certainly shifting unregulated costs to regulated entities and regulated revenues to unregulated entities would tend to make the unregulated entities appear more profitable than they are and vice versa. In the past, such behavior has been found to defraud investors by misstating earnings in some cases, such as in the case of the recent World Com scandal.

Background

In 1982 the U.S. District Court for the District of Columbia issued its landmark decision ordering the break up of AT&T. United States v. American Telephone and Telegraph Company, 552 F.Supp. 131 (DC Cir. 1982). In that decision, Judge Harold Greene recognized the importance of the large yellow pages subsidy to local telephone service rates. Judge Greene acknowledged that this subsidy occurs, whether yellow pages are provided by an independent organization or directly by the Bell operating company. Id. at p 193 fn.252. It was because of this contribution that Judge Green left the yellow page activity and contribution with the Bell operating companies even though he recognized that it was not a natural monopoly and in fact was already a competitive market.

Following the Court order breaking up AT&T, divestiture occurred in New Hampshire. As part of the divestiture, in 1984, the regulated telephone company, New England Telephone & Telegraph ("NET"), transferred its directory publishing business to a newly formed affiliate,

Nynex Information Resources Company (“NIRC”). In return for the transfer NET received from NRIC the margin, i.e. revenues less expenses, including a rate of return, which NET would have received had it continued to own the publishing business.

In 1991 NET and NRIC entered into a new series of agreements concerning its directory publishing and yellow pages operation. The result of these agreements was that the yellow pages affiliate retained the exclusive right to publish the telephone directory for the regulated telephone company as well as the exclusive right to bundle the yellow pages with the telephone directory. Under the 1991 Agreements NET continued to receive all of the yellow pages revenues less expenses including a rate of return. As a result, from 1984 until 1998 NET, and subsequently its successor Verizon-NH, received the net revenues of the affiliate publishing operation less a rate of return for the yellow pages affiliate.

During this 1984-1998 time frame Congress enacted amendments to the Telecommunications Act of 1934. (“96 Act”) 47 U.S.C. Sections 151 et seq. The 96 Act preserved Judge Greene’s arrangement regarding directory publishing by allowing the Bells, defined as ILEC’s under the Act, to continue their directory publishing and yellow pages advertising activities. The 96 Act also supported Judge Greene’s conclusion that directory publishing was competitive and responded to competitors complaints that the Bells were obstructing access to listing information by requiring equal access on equal terms to the Bells listing information. 47 U.S.C. Section 222(e). Finally, the 96 Act continued Judge Green’s restriction on the Bell’s electronic publishing, United States v. American Telephone and Telegraph, at p.193 fn.253, by restricting the Bells electronic publishing activities until electronic publishing became more fully competitive. These restrictions remained in effect until February 8, 2000. 47 U.S.C. Section 274 (g).

On December 31, 1998, Verizon-NH terminated the arrangements with its yellow pages affiliate and put into place a new series of contracts. The new affiliate contracts continued to give the Verizon competitive affiliate an exclusive right to publish directories and to bundle them with the yellow pages, but did not provide for any sharing of yellow page revenues with the regulated telephone company. On March 8, 2000, Verizon-NH filed copies of the new affiliate contracts with the Commission. The Commission took no action to either approve or disapprove the contracts and thus allowed them to go into effect. See, RSA 366:3. Beginning in January 1999, Verizon filed monthly and annual reports with the Commission which evidenced the substantially reduced yellow pages revenues in account 5230.

The Commission did not discover the revenue shift until it received the results of an independent audit by Liberty Consultants in September 2002. The independent auditors, estimated the revenue impact of the loss of this yellow page revenue in New Hampshire in 2000 to be \$24,000,000, however, Verizon has refused to provide any data on the yellow pages revenues for New Hampshire, claiming that such data is no longer available.

Argument

1. The Commission has Authority to require Verizon-NH to Impute Yellow Pages Revenues to its Regulated Telephone Operations and to modify its Affiliate Contracts to include Revenue Sharing.

The Commission has plenary ratemaking powers over public utilities under RSA 378:7.

“Whenever the commission shall be of opinion, after a hearing had upon its own motion or upon complaint, that the rates, fares or charges demanded or collected, or proposed to be demanded or collected, by any public utility for service rendered or to be rendered are unjust or unreasonable, or that the regulations or practices of such public utility affecting such rates are unjust or unreasonable, or in any wise in violation of any provision of law, or that the maximum rates, fares or charges chargeable by any such public utility are insufficient, the commission shall

determine the just and reasonable or lawful rates, fares and charges to be thereafter observed and in force as the maximum to be charged for the service to be performed, and shall fix the same by order to be served upon all public utilities by which such rates, fares and charges are thereafter to be observed. The commission shall be under no obligation to investigate any rate matter which it has investigated within a period of 2 years, but may do so within said period at its discretion.”

See also, State, v. New England Telephone & Telegraph Co., 103 N.H. 394 (1961) (Commission has broad authority in matters concerning rates.).

Verizon-NH is deemed a public utility by the Commission and its rates are set through traditional rate of return regulation. The Commission’s rules require every telephone utility in New Hampshire to provide a published telephone directory to each of its customers at least once a year. Puc Rule 405.04. In compliance with Commission rules Verizon-NH publishes its telephone directories through its competitive publishing affiliate. The directory listing services are also described in Verizon’s local exchange tariff and each customer is allowed one alphabetical listing without additional charge as part of basic local telephone service. See, Verizon-NH Tariff 83 Section 5.6.1. Verizon-NH’s provision of telephone directories is regulated and the costs are included within Verizon-NH’s basic telephone tariff. The Commission has traditionally considered the directory publishing, including yellow pages costs and revenues, as part of the ratemaking process in setting basic telephone rates. See, Re New England Telephone and Telegraph Company, 65 PUC 564, 578 (1980) (Commission used directory advertising revenues to determine regulated telephone company income.) Relevant law on this point has not changed.

In the 1982 Court Decision breaking up AT&T the Court determined that it was not in the public interest to prohibit the local telephone companies from directory and yellow pages publication. Judge Greene concluded that this was because “[a]ll those who commented on or have studied the issue agree that the Yellow Pages provide a significant subsidy to local

telephone rates. This subsidy would likely continue if the Operating Companies were permitted to continue to publish the Yellow Pages.” United States v. American Telephone and Telegraph Company, 552 F. Supp. 131, 193-94 (DC Cir.1982). Accordingly, the local Bell Operating Companies, or their affiliates, have continued to publish both telephone directories and yellow page listings despite the break up of AT&T. The local Bells’ freedom to publish directories and yellow pages continued under the 96 Act, as did the competitive nature of directory publishing.

In New Hampshire, the Commission allowed the transfer of the directory publishing business to an affiliate, NRIC, but continued the revenue sharing arrangement. The 96 Act did not prohibit continued state regulation of the directory and yellow page publishing activities of the local Bells, any more than it prohibited local regulation of basic telephone service even after it has been declared competitive. 47 U.S.C. Section 271. The Commission has authority under its state rate making statutes to continue to require yellow pages revenue to be included in regulated basic telephone rates.

Clearly RSA 366:5 gives the Commission authority to modify any affiliate agreement after investigation and hearing:

“The commission shall have full power and authority to investigate any such contract, arrangement, purchase, or sale and, if the commission after notice and hearing shall find any such contract, arrangement, purchase, or sale to be unjust or unreasonable, the commission may make such reasonable order relating thereto as the public good requires. In any such investigation, the burden shall be on the public utility and affiliate to prove the reasonableness of any such contract, arrangement, purchase, or sale with, from, or to an affiliate....” RSA 366:5

The Commission may determine that the current yellow pages affiliate contracts are not in the public interest and order any modification which it deems appropriate.

2. Verizon’s Arguments against Imputation are simply Red Herrings

Verizon makes several arguments against the Commission’s ability to impute yellow pages revenues to Verizon-NH. Verizon claims revenue imputation is inconsistent with sections

222 (e), 254 and 274 of the 96 Act and it also claims that the imputation is anti-competitive toward yellow pages competitors.

Section 222 (e) principally requires the incumbent telephone carrier, in this case Verizon-NH, to provide directory listings on a non-discriminatory basis at reasonable rates and terms to others wishing to publish competing directories. As discussed earlier, there is no prohibition in this section against regulatory requirements to share revenue between a competitive yellow pages publishing affiliate and its regulated telephone affiliate. Verizon-NH has not cited any such prohibition, nor has it located any case law interpreting this provision in this fashion. Although Verizon repeatedly cites the Federal Communications Commission (“FCC”) Third Report and Order, CC Docket No. 96-115 released September 9, 1999, as a prohibition on yellow pages revenue imputation, there is no discussion of the issue in that order, nor does Verizon cite any.

Verizon also uses section 274 as a prohibition upon the revenue imputation recommended by Commission Staff. Section 274 deals with electronic publishing activities by a local Bell operating company. The only reason it comes into play in this case at all is that Verizon chose to combine its directory publishing, yellow pages publishing and electronic publishing, in one affiliate. The revenue imputation would not violate section 274 if the yellow pages publishing and directory publishing were handled by a separate affiliate from the electronic publishing activities. In addition, section 274 sunsets in its entirety on February 8, 2000, a full month before the new affiliate agreements were even filed by Verizon-NH with the Commission. Hence this section no longer prohibits Verizon’s use of any affiliate arrangement this Commission deems appropriate. See, 47 U.S.C. Section 274 (g).

Verizon’s arguments with respect to section 254 involve its attempt to construe this Commission’s revenue imputation as a “contribution to universal service.” This is a creative

argument which finds no support in FCC decisions. Verizon can point to no instance where this type of yellow pages revenue imputation has been deemed a contribution to universal service, although a number of states have required imputations of yellow page revenues.

Verizon-NH's arguments concerning the anti-competitive nature of the Commission Staff's proposed imputation of revenues are also illogical. Verizon-NH continues to dominate both the local telephone market and the directory publishing market. Although Verizon's claim that both local phone service and directory publishing services are considered competitive under the 96 Act is correct, that does not mean that an imputation of yellow page revenues is anti-competitive. Other providers of these two competitive services are free to bundle local telephone services with directory publishing and offer the same reduction in local phone rates which Verizon-NH offers as a result of its bundling and the Commission's revenue imputation. If such an arrangement were significantly anti-competitive, then Judge Greene would have revised his opinion accordingly, and further the 96 Act would have expressly prohibited such a practice.

Respectfully submitted,

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Dated: April 25, 2003

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